

**ALABAMA PREPAID AFFORDABLE
COLLEGE TUITION PROGRAM**

FINANCIAL REPORT

SEPTEMBER 30, 2008

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
Alabama Prepaid Affordable College Tuition Program
Montgomery, Alabama

We have audited the accompanying statement of fiduciary net assets of the Alabama Prepaid Affordable College Tuition Program, a program of the Wallace-Folsom College Savings Investment Plan and a private-purpose trust fund of the State of Alabama, as of and for the year ended September 30, 2008 and the related statement of changes in fiduciary net assets for the year then ended. These financial statements are the responsibility of the Alabama Prepaid Affordable College Tuition Program. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Alabama Prepaid Affordable College Tuition Program, a private-purpose trust fund, and do not purport to, and are not intended to present fairly the financial position of the State of Alabama, and the results of its operations and the cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the Alabama Prepaid Affordable College Tuition Program as of September 30, 2008 and the changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 4, the volatile and unfavorable conditions in the global financial markets persisted beyond September 30, 2008 into 2009 and resulted in additional declines in the value of the Alabama Prepaid Affordable College Tuition Program's investments.

In accordance with *Government Auditing Standards*, we have also issued our report dated March xx, 2009, on our consideration of the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 5 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Alabama Prepaid Affordable College Tuition Program. The supplementary information on pages 20 and 21 is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Alabama Prepaid Affordable College Tuition Program. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

Macon, Georgia
March xx, 2009

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

MANAGEMENT'S DISCUSSION AND ANALYSIS SEPTEMBER 30, 2008

The following is designed to provide an understanding of various factors related to the Alabama Prepaid Affordable College Tuition Program's (the "PACT Program") operations and financial condition. This information should be read in conjunction with the financial statements and related notes. The purpose of this information is to focus on significant changes in the financial condition during the fiscal year ended September 30, 2008, and highlight events that occurred during the year.

The PACT Program is classified as a fiduciary fund in the State of Alabama Comprehensive Annual Financial Report (CAFR).

Assets

The assets of the PACT Program include cash, receivables, investments, and other assets. Assets were \$718,072,760 and \$898,548,289 as of September 30, 2008 and 2007, respectively. The decrease of \$180,475,529 was substantially a result from the unprecedented turmoil in the financial markets caused by a mortgage crisis and default of several large banks.

The composition of the PACT Program's investment securities portfolio reflects the PACT Program Board's investment strategy of strategic asset allocation for an efficient, well diversified and manageable portfolio for the long term, while maintaining an appropriate level of liquidity to meet tuition benefit obligations. The Board conducted an Asset/Liability study In February 2008. Based on this study and recommendation of our Investment Consultant, a new asset allocation was adopted by the Board in November of 2008. The allocation adopted is comprised of 38% domestic large/mid cap equity, 9% domestic small cap equity, 20% International equity, 23% domestic fixed income, and 10% real estate. Asset rebalancing of the investment portfolios may occur as markets fluctuate but was not required during the year.

To diversify PACT Program assets so as to minimize the risk associated with the dependence on the success of one enterprise, the Board has selected nine managers to invest plan assets. During 2008, Request for Proposals were widely disseminated for a passive domestic fixed income manager and a real estate manager.

The Board retains an investment consultant to evaluate, monitor and report on the investment portfolio and investment manager returns, to provide risk/return assumptions on investments, to recommend diversification, and to monitor compliance with the adopted investment policy. During the year, the Board had extensive discussions with the consultant concerning manager performance and issues of concern with turmoil in the market,

The Investment Policy and Manager Guidelines were reviewed. The board requested a revised policy statement to reflect the change in asset allocation and the various issues raised concerning securities and various manager guidelines. Subsequently, the policy statement was adopted in November of 2008.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following table represents the Program's investment portfolio, asset allocation, and corresponding annual rates of return as of September 30, 2008. Cash and cash equivalents are excluded.

ASSET CATEGORY	MARKET VALUE	PERCENT	ANNUAL RETURN (NET OF FEES)
Fixed income	\$ 183,681,495	30.34%	(2.64%)
Domestic equity	315,253,014	52.07%	(21.37%)
International equity	106,512,131	17.59%	(23.79%)

The following table represents the Program's investment portfolio, asset allocation and corresponding annual rates of return as of September 30, 2007. Cash and cash equivalents are excluded.

ASSET CATEGORY	MARKET VALUE	PERCENT	ANNUAL RETURN (NET OF FEES)
Fixed income	\$ 200,268,867	25.52%	5.53%
Domestic equity	405,215,434	51.64%	15.36%
International equity	179,198,821	22.84%	26.71%

Liabilities

Liabilities of the PACT Program consist of payables and accruals. Liabilities were \$144,900,009 and \$134,689,600 at September 30, 2008 and 2007, respectively. The increase in liabilities was primarily due to a \$14.7 million increase in securities lending collateral offset by a decrease in other liabilities of \$8.0 million. Warrants and accounts payable include fall semester tuition benefits payable of \$30.1 million and \$25.7 million at September 30, 2008 and 2007, respectively.

Other liabilities consist of forward settling to be announced (TBA) mortgage-backed securities of \$27.3 million and \$35.2 million at September 30, 2008 and 2007, respectively. These securities and amounts are within the acceptable guidelines of the Investment Policy.

Additions

Additions totaled (\$118,532,714) and \$135,401,839 for fiscal years ended September 30, 2008 and 2007, respectively. The securities lending program resulted in net income to the PACT of \$538,564 for the fiscal year as compared to \$53,432 for 2007. At year end, PACT's securities lending activity was comprised of \$12.1 million domestic fixed securities and \$73.8 million domestic and international equity securities.

Contract payments decreased 3.8%, due to a larger number of contracts being paid in full. Other income, consisting primarily of administrative fees, increased 10.6%. There were no fee increases.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Deductions

Deductions totaled \$72,153,224 and \$63,138,338 for fiscal years ending September 30, 2008 and 2007, respectively. Deductions include salaries, professional services, contract cancellation refunds, and benefits paid to colleges and universities.

The largest deduction from the PACT Program is the amount of monies paid to the colleges and universities for tuition and qualified fees. It is expected this amount will increase every year as the PACT Program ages with more contracts eligible for benefit payments and college tuition increases. For fiscal year ending 2008 the PACT Program paid \$64.1 million to over 400 colleges and universities across the nation for approximately 13,000 beneficiaries, as compared to \$54.9 million paid in fiscal year ending 2007.

Professional service expenses decreased approximately 9.2% over 2007. The decrease was largely due to the decrease in market value of fund assets.

Summary

For fiscal year ending 2008, PACT had net assets of \$573,172,751. Adding the actuarial present value of future contract payments of \$53.6 million to net assets and dividing by the actuarial present value of future tuition benefit payments of \$933.1 million, the result is an actuarial funded status of 67.2%. This is a decrease from the 2007 actuarial funded status of 97.6%. The decrease in the actuarial funded status results from the drastic decrease in market value of program assets.

Actuarial assumptions are reviewed and approved by the Board annually to reflect expected results believed to be realistic based on historical information, economic data and expert guidance. The 2008 Actuarial Report is available at www.treasury.alabama.gov. The report should be read in its entirety in conjunction with the financial statements so that projections can be properly interpreted.

The fiscal period ending September 30, 2008, proved to be an extremely challenging year for investors around the world. Since inception, PACT has employed a diversification of asset strategy to aid in down markets. However, the severity of the down market was so extreme that even the diversification of assets strategy did not prove beneficial this time, as all asset classes showed significant declines. The harsh recession will likely cause calendar year 2008 to be one of the worst on record, with expectation it will be prolonged into 2009.

Requests for Information

This financial report is designed to provide a general overview of the PACT's finances for all those with an interest in the PACT's activities and finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Alabama State Treasurer Office at the Alabama State Capital, 600 Dexter Avenue, Room S-106, Montgomery, Alabama 36104.

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

STATEMENT OF FIDUCIARY NET ASSETS SEPTEMBER 30, 2008

ASSETS	
Cash and cash equivalents	\$ 23,836,601
Interest receivable	2,577,842
Foreign taxes receivable	304,961
Investments	605,446,640
Invested securities lending collateral	85,906,716
Total assets	<u>718,072,760</u>
LIABILITIES	
Warrants and accounts payable	31,620,254
Accrued liabilities	67,467
Other liabilities	27,305,572
Securities lending collateral	85,906,716
Total liabilities	<u>144,900,009</u>
NET ASSETS	
Held in trust for tuition benefit payments and other purposes	<u>\$ 573,172,751</u>

See Notes to Financial Statements.

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS SEPTEMBER 30, 2008

ADDITIONS (REDUCTIONS)	
Contract payments	<u>\$ 27,772,976</u>
Income (loss) from investment activities:	
From investing activities:	
Interest and dividend income	23,225,720
Net depreciation in fair value of investments	<u>(171,026,278)</u>
Net investment loss from investing activities	<u>(147,800,558)</u>
From securities lending:	
Securities lending income	3,907,462
Less: securities lending expenses	
Borrower rebates	(3,139,907)
Management fees	<u>(228,991)</u>
Total securities lending expenses	<u>(3,368,898)</u>
Net income from securities lending activities	<u>538,564</u>
Total loss from investment activities	<u>(147,261,994)</u>
Other income	<u>956,304</u>
Total reductions	<u>(118,532,714)</u>
DEDUCTIONS	
Tuition benefits	64,059,214
Salaries and other administrative expenses	335,598
Professional services	3,565,579
Cancellation refunds	<u>4,192,833</u>
Total deductions	<u>72,153,224</u>
Change in net assets	<u>(190,685,938)</u>
Net assets, beginning	<u>763,858,689</u>
Net assets, ending	<u>\$ 573,172,751</u>

See Notes to Financial Statements.

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

NOTES TO FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the PACT Program:

The Alabama Prepaid Affordable College Tuition Program (the "PACT Program") is a part of the Wallace-Folsom College Savings Investment Plan. The PACT Program includes the PACT Trust Fund and the PACT Administrative Fund. These financial statements do not include any other programs of the Wallace-Folsom College Savings Investment Plan.

The PACT Program operates under the provisions of the Code of Alabama 1975, Section 16-33C-1 through 9, as amended. The PACT Program is administratively located within the Alabama State Treasurer's Office. The PACT Program's property, income, and operations have been statutorily exempted from all taxation by the State and its political subdivisions. The PACT Disclosure Statement provides that neither the contract purchaser nor beneficiary has any recourse against the Treasurer, the Board, the PACT Program, any other state or federal government agency, or the State of Alabama in connection with any obligations arising out of the PACT contracts.

The PACT Program is governed by a ten-member Board of Trustees consisting of the Treasurer of the State of Alabama, the Lieutenant Governor or designee, the executive director of the Alabama Commission on Higher Education or designee, the chancellor of the Alabama Department of Postsecondary Education or designee, each of whom shall serve ex officio; a representative of the Council of College and University Presidents; one person appointed by the Treasurer; one person appointed by the Speaker of the House of Representatives; one person appointed by the Lieutenant Governor; and two persons appointed by the Governor.

The PACT Program provides, in return for a specified actuarially determined payment, a child's undergraduate tuition and qualified fees at any Alabama public university or community college. For beneficiaries that choose to attend private or out-of-state institutions, the PACT Program will provide tuition payments at the current weighted average cost of tuition at Alabama public four-year institutions. The purchase amount is based on several factors, including tuition costs, the beneficiary's age and grade in school, anticipated investment earnings, and anticipated tuition rate increases.

Reporting Entity:

The PACT Program is a part of the State of Alabama's reporting entity and is reported as a private-purpose trust fund in the State of Alabama Comprehensive Annual Financial Report (CAFR). The notes accompanying these financial statements relate directly to the PACT Program.

NOTES TO FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus and Basis of Accounting:

The PACT Program's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Cash and Cash Equivalents:

The PACT Program considers all highly liquid investments with a maturity of twelve months or less at the time of issue to be cash equivalents. Cash and cash equivalents consist of bank deposits, amounts invested in repurchase agreements, money market mutual funds and securities rated A-1 by Moody's, P1 by Standard & Poor's or better by a recognized credit rating service.

Investments:

All plan investments are stated at fair value in the Statement of Fiduciary Net Assets and are managed by third-party money managers. All investment income, including changes in fair value, are reported as additions (reductions) in the Statement of Changes in Fiduciary Net Assets. Fair values for investment securities are based on quoted market prices, where available. Otherwise, fair values are based on quoted market prices of comparable instruments. Purchases and sales of securities are recorded by the trustee on the trade date. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

Income Taxes:

The Internal Revenue Code provides that state tuition plans that meet certain requirements are exempt from income taxation. The PACT Program's rules and regulations meet those requirements. Accordingly, no provision for income taxes has been recorded for the year ended September 30, 2008, nor for prior years.

Management Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS

Cash and cash equivalents at September 30, 2008 consist of the following:

<u>Account Type</u>	<u>Fair Value</u>
Interest earning deposits	\$ 938,604
Money market mutual funds	20,482,997
Repurchase agreements	2,415,000
	<u>\$ 23,836,601</u>

As of September 30, 2008, the PACT Program had ten money managers to invest plan assets. The PACT Program has an investment consultant who assists the Board of Directors in monitoring compliance with the PACT Program's investment policy and monitoring performance of the money managers.

Deposits and investments are subject to certain types of risk including interest rate risk, custodial credit risk, and foreign currency risk. The following describes those risks.

Deposits – Custodial Credit Risk – The PACT Program maintains its cash in bank deposit accounts, which at times exceed federally insured limits. The PACT Program has not experienced any losses in such accounts. The PACT Program believes it is not exposed to any significant credit risk.

Investments – Interest Rate Risk – The fair value of fixed-maturity investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods.

Investments – Custodial Credit Risk – For an investment, custodial credit risk is the risk that an entity will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if the counterparty fails. The PACT Program's custodian holds all investments of the PACT Program in the PACT Program's name, with the exception of repurchase agreements. The securities underlying repurchase agreements are held in trust for the PACT Program in the name of the trustee, not in the name of the PACT Program.

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

Foreign Currency Risk – For an investment, foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. In order for an international equity security to be eligible for purchase by the PACT Program, the issuing company must have an available operating history of at least three years, and have a market capitalization of at least \$100 million at the time of purchase.

Concentration of Credit Risk – The investment policies limit the aggregate amount that can be invested in each class of investments and provides further limitations on investments by individual money managers. The policy limits are as follows:

- Domestic Fixed Income and Cash
 - Limited to 28% of the market value of the aggregate portfolio, plus or minus 5%. With the exception of those situations involving reorganization of fund assets, debt investments should only be made in issues with an outstanding value of at least \$50 million, valued at part, at the time of purchase.
 - On an individual money manager basis, no more than 5% of the total market value of all debt instruments should be invested in the debt obligations of any one issuer, with the exception of securities issued and collateralized by the United States Government, or its agencies, which may be held without limitation. Holdings of any individual issue must be 5% or less of the outstanding value of the total issue.
- Domestic Equity
 - Large/mid cap stocks – limited to 42% of the market value of the aggregate portfolio, plus or minus 5%.
 - Small cap stocks – limited to 9% of the market value of the aggregate portfolio, plus or minus 3%.
 - The PACT Program's investment policy states that equity holdings will be restricted to readily marketable securities of corporations that are actively traded on major exchanges including the NASDAQ in the United States. Equity holdings may include American Depositary Receipts traded on U.S. exchanges. Preferred and convertible preferred stocks may be held. Publicly traded Real Estate Investment Trusts (REITs) may also be held and are considered part of the allocation to stocks. The policy is to invest in equity securities of issuers with an available operating history of at least three years, and a market capitalization of at least \$50 million at the time of purchase.
 - On an individual money manager basis, no more than 5% of the total stock portfolio may be invested in the common stock of any one corporation at the time of purchase, and no more than 7% in any one corporation at fair market value. No more than 5% of the outstanding shares of any one company may be held. No more than the lesser of these times the sector weight in the index and 40% valued at market may be held in any one economic sector.

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

- International Equity
 - Limited to 21% of the market value of the aggregate portfolio, plus or minus 3%. Equity holdings may include American Depositary Receipts and Global Depositary Receipts traded on U.S. exchanges or major exchanges in countries outside the United States. Convertible and non-convertible preferred stocks may be held. The policy is to invest in equity securities of issuers with an available operating history of at least three years, and a market capitalization of at least \$100 million at the time of purchase.
 - On an individual money manager basis, no more than 5% of the total stock portfolio may be invested in the common stock of any one corporation at the time of purchase, and no more than 7% in any one corporation at fair market value. Furthermore, no more than 5% of the outstanding shares of any one company may be held. No more than the lesser of two times the sector weight in the index and 40% valued at market may be held in any one economic sector weight in the index and 4% valued at market may be held in any one economic sector as defined by Morgan Stanley Capital International, Inc. Exposure to emerging markets securities shall be limited to 10% of the market value of the portfolio.

On September 30, 2008, the PACT Program did not have debt or equity investments in any one organization which represented greater than 5% of plan net assets.

The following table provides information as of September 30, 2008, concerning the fair value of investments, interest rate risk, and foreign currency risk:

Type of Investment	Investments				Total Fair Value
	Investment Maturities at Fair Value (In Years)				
	Less Than 1	1 - 5	6 - 10	More Than 10	
<i>Fixed Maturity</i>					
Domestic:					
U.S. Government guaranteed	\$ -	\$ 8,183,164	\$ 151,227	\$ 6,363,260	\$ 14,697,651
U.S. Agency Securities	-	14,325,420	438,754	6,102,035	20,866,209
Mortgage backed securities	-	494,109	1,889,445	80,953,652	83,337,206
Corporate bonds	1,751,918	9,359,710	15,449,580	10,233,038	36,794,246
Derivative instruments:					
TBA mortgage backed securities	-	-	-	27,305,572	27,305,572
Other derivative instruments	(607,234)	-	-	-	(607,234)
Total domestic fixed maturity	1,144,684	32,362,403	17,929,006	130,957,557	182,393,650
International:					
Canada	-	-	-	109,034	109,034
Germany	-	-	571,579	-	571,579
Total international fixed maturity	-	-	571,579	109,034	680,613
Total fixed maturity	1,144,684	32,362,403	18,500,585	131,066,591	183,074,263

NOTES TO FINANCIAL STATEMENTS

NOTE 2. DEPOSITS AND INVESTMENTS (CONTINUED)

Investments (Continued)

Type of Investment	Total Fair Value
<i>Equities</i>	
Domestic:	\$ 318,603,425
International:	
Australia	4,876,219
Belgium	420,735
Brazil	214,283
Canada	7,445,538
Denmark	140,816
European Union	244,233
Finland	576,378
France	9,103,459
Germany	10,661,328
Greece	1,040,557
Hong Kong	3,842,963
Italy	2,545,005
Japan	21,548,888
Luxemburge	500,295
Malaysia	58,677
Mexico	347,019
Netherlands	5,455,252
Norway	484,611
Russia	603,857
Singapore	589,901
South Korea	74,590
Spain	3,765,605
Sweden	627,926
Switzerland	9,822,831
United Kingdom	18,777,986
Total international equities	<u>103,768,952</u>
Total equities	<u>422,372,377</u>
Total investments	<u>\$ 605,446,640</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 2. DEPOSITS AND INVESTMENTS (CONTINUED)

The following table provides information as of September 30, 2008, concerning credit risk:

Rating of Fixed Maturity Investments		Fair Value As A Percent of Total Fixed Maturity Fair Value
Moody's Ratings ⁽¹⁾ (Unless Noted)	Fair Value	
Aaa	\$ 138,630,493	75.724 %
AAA (SP)	369,368	0.202
Aa1	786,285	0.429
Aa2	1,187,192	0.648
Aa3	1,182,988	0.646
A1	3,244,826	1.772
A2	2,672,892	1.460
A3	3,666,495	2.003
Baa1	5,095,247	2.783
Baa2	6,889,285	3.763
Baa3	6,350,917	3.469
Ba1	787,493	0.430
Ba2	2,497,383	1.364
Ba3	1,494,675	0.816
BBB (SP)	181,000	0.099
B1	2,886,572	1.577
B2	1,085,319	0.593
B3	1,713,651	0.936
Caa1	1,445,858	0.790
Caa2	292,763	0.160
Caa3	97,600	0.053
C	100,059	0.055
Not rated	415,902	0.227
	<u>\$ 183,074,263</u>	<u>100.000 %</u>

⁽¹⁾ Moody's ratings are used when available. Standard & Poor's rating is used when it is available and a Moody rating is not. Standard & Poor's ratings are denoted by (SP). Securities not rated primarily consist of commitments to purchase futures contracts and forward contracts.

NOTES TO FINANCIAL STATEMENTS

NOTE 2. DEPOSITS AND INVESTMENTS (CONTINUED)

Securities Lending Program – The PACT Program's investment policy approved by the Board of Trustees permits the PACT Program to enter into securities lending transactions defined as loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. There are no restrictions on the amount of loans that can be made. The PACT Program's custodian, Bank of New York, administers the program and acts as an agent for the PACT Program. Certain securities of the PACT Program are loaned to borrowers approved by the PACT Program. Approved borrowers of securities provide acceptable cash collateral in the form of federal funds or New York Clearing House funds as applicable for a particular loan. The Bank of New York has provided loss indemnification to the PACT Program in the event that the borrower does not return the market value of the securities loaned. All security loans are open loans and can be terminated on demand by the PACT Program or the borrower. The initial collateral received shall have 1) in the case of loaned securities denominated in United States Dollars, cash collateral in the amount of 102% of the market value of the loaned securities or 2) in the case of loaned securities which are not denominated in United States Dollars, cash collateral in the amount of 105% of the market value of the loaned securities. Pursuant to the terms of the applicable securities loan agreement, Bank of New York shall, in accordance with Bank of New York's reasonable and customary practices, mark loaned securities and collateral to their fair value each business day based upon the fair value of the collateral and the loaned securities at the close of the business employing the most recently available pricing information and receive and deliver collateral in order to maintain the value of the collateral at no less than 100% of the fair value of the loaned securities.

As of September 30, 2008, the average term of the loans was 67 days. Cash collateral investments are matured as needed to fulfill loan obligations. There is no direct matching of the maturities of the loans with the investments made with cash collateral.

The following describes the manner in which the Bank of New York is authorized to invest and reinvest cash collateral.

- Securities issued or fully insured by the United States government and any agency, instrumentality or establishments of the United States government (Government Securities).
- High-grade commercial paper, notes, bonds and other debt obligations including promissory notes, funding agreements and guaranteed investment contracts whether or not registered under the Securities Act of 1933, as amended. Such obligations may have fixed, floating, or variable rate interest payment provisions. Obligations maturing within one year shall be issued by issuers rated at least A-1 (by Standard & Poor's) or P-1 (by Moody's). Obligations maturing beyond one year shall be issued by issuers rated at least A (by Standard & Poor's) or A2 (by Moody's).

NOTES TO FINANCIAL STATEMENTS

NOTE 2. DEPOSITS AND INVESTMENTS (CONTINUED)

- Asset-backed securities which carry the highest credit rating by Standard & Poor's or Moody's.
- Certificates of deposit, time deposits and other bank obligations of U.S. banks, their branches and subsidiaries. Obligations will be rated A-1 (Standard & Poor's) or P-1 (Moody's if maturing within one year or rated A (Standard & Poor's) or A2 (Moody's if maturing beyond one year).
- Repurchase and reverse repurchase agreements collateralized by approved investments.
- Securities, units, shares and other participations in money market funds, unregistered short-term investment funds, pools or trusts.
- Government securities have no maturity limit. Fixed rate instruments shall have a maturity of no greater than 13 months. Floating rate instruments rated "A" or "AA" shall have maturities no greater than three years with resets no less frequent than three months. Floating rate instruments rated "AAA" shall have maturities no greater than five years with resets no less frequent than three months.

As of September 30, 2008, the fair value of the securities on loan was \$85,947,170. The fair value of the cash collateral pledged by the borrowers was \$85,906,716. The PACT Program has no credit risk exposure to borrowers because the amounts the PACT Program owes the borrowers exceeds the amounts the borrowers owe the PACT Program. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior period losses during the year.

Investments purchased with cash collateral are held by the custodial agent, but not in the name of the PACT Program. The following table provides information as of September 30, 2008 concerning securities lent:

Securities Lending - Investments Lent and Collateral Received (at Fair Value)

Securities Lent	Fair Value of Underlying Securities	Cash Collateral Investment Value
<i>For cash collateral</i>		
Domestic Fixed Maturities	\$ 12,135,141	\$ 12,479,270
Domestic Equity	73,007,024	72,653,107
International Equity	805,005	774,339
	<u>\$ 85,947,170</u>	<u>\$ 85,906,716</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 2. DEPOSITS AND INVESTMENTS (CONTINUED)

Mortgage-backed Securities – As of September 30, 2008, the PACT Program had investments in mortgage-backed securities. Embedded prepayment options cause these investments to be highly sensitive to changes in interest rates. Prepayments by the obliges of the underlying assets reduce the total interest payments to be received. Generally, when interest rates fall, obliges tend to prepay the mortgages thus eliminating the stream of interest payments that would have been received under the original amortization schedule. The resulting reduction in cash flow diminishes the fair value of mortgage-backed securities. Maturities may differ from contractual maturities (as shown in the table of investments) in mortgage-backed securities due to prepayment characteristics of these securities. Average life is an acceptable expected maturity.

As of September 30, 2008, the PACT Program had investments in forward settling TBA mortgage-backed securities in the amount of \$27,305,572. Included in other liabilities on the Statement of Fiduciary Net Assets is a corresponding liability for the same amount. Generally, these securities are closed with a gain or loss prior to settlement. However, the PACT Program would be obligated for these amounts should the securities be delivered.

NOTE 3. FUTURE TUITION BENEFIT PAYMENTS AND FUTURE CONTRACT PAYMENTS

An actuary determines future tuition benefit payments and future contract payments. The standardized measurement is the actuarial present value of such payments. This valuation method reflects the present value of estimated tuition benefits that will be paid in future years and the present value of estimated tuition benefits that will be paid in future years and the present value of estimated contract payments that will be received from installment contract purchasers in future years. The significant actuarial assumptions used and results from the most recent valuation are as follows:

Date of latest actuarial valuation	September 30, 2008
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Assumptions:

Rate of return on investments	8.02%
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Future tuition increases	7.25%
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Enrollment of beneficiaries	10% will attend a junior/community college; 14% tuition bias for four-year universities; 2% tuition bias for two-year colleges
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NOTES TO FINANCIAL STATEMENTS

NOTE 3. FUTURE TUITION BENEFIT PAYMENTS AND FUTURE CONTRACT PAYMENTS (Continued)

Assumptions: (continued)

Contract cancellations

The actuarial valuation recognizes cancellations in accordance with the following schedule:

	Lump Sum	60 Monthly Payments	Extended Monthly Payments
Year of purchase	0.50%	5.00%	6.00%
Year of purchase + 1	0.50%	2.00%	5.00%
Year of purchase + 2	0.50%	1.00%	4.00%
Year of purchase + 3	0.50%	1.00%	4.00%
Year of purchase + 4	0.50%	1.00%	3.00%
Thereafter	0.50%	1.00%	2.00%

The assumptions shown above do not reflect the initial involuntary cancellations that result shortly after each enrollment period for contract purchasers who never make payments on their contracts.

Additionally, actuarial assumptions assume for 4-year contracts that the average beneficiary will use 128 credit hours and 8 semester fee payments according to the following table. For 1-year contracts, actuarial assumptions assume the average beneficiary will use 32 credit hours and 2 semester fee payments.

Timing	4-Year Contracts		1-Year Contracts	
	Credit Hours	Fee Usage	Credit Hours	Fee Usage
Year 1	30	2 semesters	32	2 semesters
Year 2	30	2 semesters	Nil	Nil
Year 3	30	2 semesters	Nil	Nil
Year 4	30	2 semesters	Nil	Nil
Year 5	8	Nil	Nil	Nil

Within an academic year, contract usage is assumed to be 45% for the fall semester, paid November 1, 45% for the spring semester, paid March 1, and 10% for the summer semester, paid August 1.

NOTES TO FINANCIAL STATEMENTS

NOTE 3. FUTURE TUITION BENEFIT PAYMENTS AND FUTURE CONTRACT PAYMENTS (Continued)

Results:

Actuarial present value of future payments expected to be made for tuition, fees and contract cancellations for all contracts sold \$ 933,072,323

Actuarial present value of future payments expected to be received from installment contract purchasers 53,653,081

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress

Actuarial Valuation Date	Net Assets Available for Benefits	Actuarial Value of Future Contract Payments	Total Assets	Actuarial Present Value of Future Tuition Benefit Payments	Assets in Excess (Deficit) of Tuition Benefit Payments	Assets as a Percentage of Tuition Benefit Payments
09/30/05	\$ 653,928,795	\$ 71,433,946	\$ 725,362,741	\$ 795,392,344	\$ (70,029,603)	91.2 %
09/30/06	691,595,188	54,404,134	745,999,322	806,535,334	(60,536,012)	92.5
09/30/07	763,858,689	53,309,201	817,167,890	836,909,570	(19,741,680)	97.6
09/30/08	573,172,751	53,653,081	626,825,832	933,072,323	(306,246,491)	67.2

NOTE 4. SUBSEQUENT EVENT

The volatile and unfavorable conditions in both the global equity and fixed income markets persisted beyond September 30, 2008 into 2009 and have resulted in additional declines in the value of the PACT Program's investments. As of February 28, 2009, management estimates that invested assets approximate \$431 million (which exclude securities lending collateral), representing a 32% decline from September 30, 2008.

SUPPLEMENTARY INFORMATION

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ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

COMBINING STATEMENT OF FIDUCIARY NET ASSETS SEPTEMBER 30, 2008

	Trust Fund	Administrative Fund	Total
ASSETS			
Cash and cash equivalents	\$ 23,500,592	\$ 336,009	\$ 23,836,601
Interest receivable	2,577,842	-	2,577,842
Foreign taxes receivable	304,961	-	304,961
Investments	605,446,640	-	605,446,640
Invested securities lending collateral	85,906,716	-	85,906,716
Total assets	<u>717,736,751</u>	<u>336,009</u>	<u>718,072,760</u>
LIABILITIES			
Due to (from) other fund	31,865	(31,865)	-
Warrants and accounts payable	31,537,862	82,392	31,620,254
Accrued liabilities	-	67,467	67,467
Other liabilities	27,305,572	-	27,305,572
Securities lending collateral	85,906,716	-	85,906,716
Total liabilities	<u>144,782,015</u>	<u>117,994</u>	<u>144,900,009</u>
NET ASSETS			
Held in trust for tuition benefit payments and other purposes	<u>\$ 572,954,736</u>	<u>\$ 218,015</u>	<u>\$ 573,172,751</u>

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS SEPTEMBER 30, 2008

	Trust Fund	Administrative Fund	Total
ADDITIONS			
Contract payments	\$ 27,772,976	\$ -	\$ 27,772,976
Investment income:			
From investing activities:			
Interest and dividend income	23,225,720	-	23,225,720
Net depreciation in fair value of investments	(171,026,278)	-	(171,026,278)
Net investment income from investing activities	(147,800,558)	-	(147,800,558)
From securities lending:			
Securities lending income	3,907,462	-	3,907,462
Less: securities lending expenses			
Borrower rebates	(3,139,907)	-	(3,139,907)
Management fees	(228,991)	-	(228,991)
Total securities lending expenses	(3,368,898)	-	(3,368,898)
Net income from securities lending activities	538,564	-	538,564
Total investment income	(147,261,994)	-	(147,261,994)
Other income	302,911	653,393	956,304
Total additions	(119,186,107)	653,393	(118,532,714)
DEDUCTIONS			
Tuition benefits	64,059,214	-	64,059,214
Salaries and other administrative expenses	765	334,833	335,598
Professional services	2,635,736	929,843	3,565,579
Cancellation refunds	4,192,833	-	4,192,833
Total deductions	70,888,548	1,264,676	72,153,224
Change in net assets before transfers	(190,074,655)	(611,283)	(190,685,938)
Transfers to (from)	(650,000)	650,000	-
Change in net assets	(190,724,655)	38,717	(190,685,938)
Net assets, beginning	763,679,391	179,298	763,858,689
Net assets, ending	\$ 572,954,736	\$ 218,015	\$ 573,172,751

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Trustees
Alabama Prepaid Affordable College Tuition Program
Montgomery, Alabama

We have audited the financial statements of the Alabama Prepaid Affordable College Tuition Program, a program of the Wallace-Folsom College Savings Investment Plan and a private-purpose trust fund of the State of Alabama, as of and for the year ended September 30, 2008, and have issued our report thereon dated March xx, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Alabama Prepaid Affordable College Tuition Program's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of Alabama Prepaid Affordable College Tuition Program in a separate letter dated March xx, 2009.

This report is intended solely for the information and use of management, the Board of Trustees, others within the Alabama Prepaid Affordable College Tuition Program, and the State of Alabama, and is not intended to be and should not be used by anyone other than these specified parties.

Macon, Georgia
March xx, 2009